WHAT LAW GOVERNS THE VALIDITY OF A CONTRACT.

III. Theoretical and Practical Criticisms of the Authorities.

FOR the purpose of criticism, the suggested rules can be divided into three classes. 1. Rules by which the intention of the parties is allowed to fix the law. There are, as has been seen, various rules belonging to this class. Most of them include a more or less conclusive presumption as to which of the several possible laws the parties intended. The differing presumptions, however, while quite inconsistent with each other do not affect the general nature of the rules. They all involve the assumption that the parties may in some way or other by their own will affect the law which applies to their contracts. 2. The rule that the place of performance governs the obligation of the contract. 3. The rule that the place of making the contract governs its obligation. Each of these rules will be taken up in turn and criticised both from a theoretical and from a practical standpoint.

1.

Let us first consider rules which in various forms and with different limitations allow the intention of the parties to govern the obligation of their contract. The fundamental objection to this in point of theory is that it involves permission to the parties to do a legislative act. It practically makes a legislative body of any two persons who choose to get together and contract. The adoption of a rule to determine which of several systems of law shall govern a given transaction is in itself an act of the law. When, for instance, it is said that the law of the domicile of the deceased person governs the devolution of his personal property at his death, this means that the law of the place where the property is situated by an act of legislation adopts this domiciliary law as the law to govern the inheritance. We are apt, as a consequence of the very general adoption of this rule, to close our eyes to the fact that it is an act of the law of the place of *situs;*

but it is quite clear that the place of *situs* may adopt this law of the domicile or not, at its pleasure, for the devolution of property within its control, and therefore that if the law of the domicile is applied it is by reason of a legislative act of the *situs*.[1] So in the case of the adoption of a law to govern the nature and obligation of a contract, it is entirely possible from the point of view of any one state that the law of that state or of some other state should be applied to the determination of the question; but if the law of that state is not applied, it is a result of the sovereign will of the state which controls the contract. Now, if it is said that this is to be left to the will of the parties to determine, that gives to the parties what is in truth the power of legislation so far as their agreement is concerned. The meaning of the suggestion, in short, is that since the parties can adopt any foreign law at their pleasure to govern their act, that at their will they can free themselves from the power of the law which would otherwise apply to their acts.

So extraordinary a power in the hands of any two individuals is absolutely anomalous; so much so that even the courts which adopt a rule of this sort have been occupied in defining limitations to the exercise of the parties' will. Thus, it is almost universally provided that the parties cannot exercise this power unless they do so in good faith. Perhaps the earliest application of this idea was in the important case of Andrews *v.* Pond.[2] In that case the contract was invalid according to the law of the place of making and also according to the law of the place of performance. The court said that while ordinarily the parties might agree on either law at their option, to govern the validity of their contract, yet in this case, where there was no *bonâ fide* agreement to submit to either law, but both laws were violated by the parties, the ordinary rule by which the parties could choose their law would not apply. Following this case the courts accepted the statement that the parties' agreement upon a law must be *bonâ fide;* but this was afterwards carried further than the case where the parties agreed to abide by neither law. In many cases, for instance, where the parties absolutely accepted and followed out the law of the place of performance the courts have nevertheless held the agreement to adopt that law not to be a *bonâ fide* agreement, simply on the ground that their intention was to avoid the more stringent provisions of the law of the place of making. This form of the

[1] Cooper *v.* Beers, 143 Ill. 25.

[2] 13 Pet. 65.

rule leaves it for the court to determine whether the parties did or did not act *bonâ fide* in adopting one law or the other, and it is sometimes difficult to anticipate what the court will decide. Thus, in two cases already cited,[1] where to the ordinary apprehension the facts were practically identical, the same court held differently as to the *bona fides* of the parties; and thus, as a result, applied different laws to what apparently were identical contracts.

Another limitation frequently enforced by the courts is a limitation upon the breadth of choice of the parties. It would obviously be impracticable to allow the parties even if they acted *bonâ fide* to select some strange foreign law to govern the obligation merely because it seemed to the parties that such a law was just or desirable. The courts have, therefore, generally confined the parties in their choice of law either to the law of the place of making or to the law of the place of performance. In one or two cases, to be sure, the courts have gone further and allowed the law of some third state to be adopted, as for instance the state of residence of a contracting party or the state of *situs* of the security.[2] In general, however, this extension is not permitted and the parties are confined rigidly to the law of the two places, that of making and that of performance.[3]

These limitations laid down by the courts evince a feeling of doubt as to the correctness or the feasibility of the unlimited rule. Theoretically, it would seem that if the rule can be justified it must be on some ground that would permit to its parties the unlimited choice in all cases, so that the parties could agree upon the law of China or of Central Africa if that was the law which really *bonâ fide* appealed to them as the one best fitted to apply to their agreement.

The theoretical objection to the rule as generally laid down appears to have presented itself forcibly to Professor Dicey, who has in his Conflict of Laws thrown the common doctrine into a form somewhat more capable of theoretical defense. He says in note 5 to his second edition of his Conflict of Laws (page 730) that the law as first stated and applied by the English courts was that everything connected with the contract is governed by the *lex loci contractus*, which they interpreted as meaning the law of the place where the

[1] Jackson *v.* Am. M. Co., 88 Ga. 756; Odom *v.* New England M. S. Co., 91 Ga. 505.

[2] Scott *v.* Perlee, 39 Oh. St. 63.

[3] Central Trust Co. *v.* Burton, 74 Wis. 329.

contract was made. He adds that a change of doctrine was then combined with verbal adherence to the old formula, which was reinterpreted so as to mean the law of the country with a view to the law whereof a contract was made; which may be the law of the place of making, but may very likely be the law of the place of performance. He then assumes a "proper law of a contract, the law which governs the obligation of the contract," or, as he calls it, its essential validity, and which he defines to be "the law or laws by which the parties to a contract intended or may fairly be presumed to have intended the contract to be governed; or, in other words, the law or laws to which the parties intended or may fairly be presumed to have intended to submit themselves." He admits the possibility of the parties, whilst really contracting with reference to one law, yet asserting their intention to have the validity of their contract determined by another law which would make it valid, and this he says they cannot do. In other words, the intention of the parties is not strictly their intention to adopt what law they please to give the contract validity, but their intention to adopt as the seat of their obligation and the real place where it is to be in force some one state, whether the place of making or of performance. It is certainly not theoretically impossible to assign a contract to some one state as the seat of the obligation and to have it governed by the law of that state. Some such suggestion has already been made by the author as solving the difficult question of what law governs a trust of chattels created *inter vivos*.[1] This suggestion was made, however, not as to the creation of a trust, but as to its administration after it had been validly created. Before such a principle can come into force it is necessary to have a trust validly created. In the same way some such doctrine might well be accepted to govern the performance of a contract once validly created; but it is still necessary to get the obligation created, and until that is done the parties are hardly in a position to discuss the seat of its performance. The ingenious suggestion does not at all relieve us of the necessity of admitting, if we accept any rule giving effect to the intention of the parties, that we allow the parties by their own will to create an obligation, where, by the law of the place under which they act, no legal obligation would be attached to the agreement.

So far of the theoretical objections to this doctrine. The practical objections are quite as conclusive. This distinction between theo-

[1] 20 HARV. L. REV. 395.

retical and practical objections is not one on which the author desires to insist. In the highest sense, an unjust rule or one that does not conform to type is an impracticable rule. If a doctrine is theoretically indefensible it is sure in the long run to lead to injustice and to inequality of operation. In that sense the whole previous argument is directed against the practicability of the rule in question. But in the immediate sense a rule which is theoretically indefensible may for a time at least work well in practice; and it is now desired to examine into the working in practice of the rule under consideration.

When considering whether a rule operates well in practice we are too apt to look at the question *a posteriori*. If, when the time comes for the court to determine the rule, it can say that in the case in which it is applied it does not work injustice or inconvenience, so far as the court can see, then it is a good practical rule and one that will commend itself to the good sense of the profession and of the public. It must be clear, however, that the practicability of a rule cannot be judged solely by a consideration of how well it will work in future cases. The direct object of the law is not to redress, but to prevent wrongs. Every actual litigation in which a rule of law is laid down represents a failure of the law to operate as it should have operated. The most practical use of a rule of law is to enable individuals to avoid a breach of the law, a dispute, and an expensive litigation. In short, the first test of the practicability of a rule of law is its certainty and the ease with which it can be stated to parties by counsel in advising them, in advance of action, upon the legality of their contemplated acts. In determining the rules for the validity of a contract it must be borne in mind that what the parties desire is to learn in advance whether their intended agreement would be a valid one, how it should be made, and what its effect would be. Parties contemplating a commercial dealing consult a lawyer a hundred times in advance of action for every time they consult him, after the contract is made and broken, to represent them in litigation. What business men need is a rule of law which a lawyer can give them when they consult him, and upon which they can act with ease and certainty.

In this sense the doctrine under consideration is absolutely impracticable. According to this doctrine it is the intention of the parties which determines the law to govern their obligation. But this intention is one which is found by the court from the facts of the case. In order to be sure that a certain law will finally be held to govern the obliga-

tion, counsel consulted in advance would need in the first place to be an expert prophet in order to know in what court the litigation would eventually take place, and in the second place a person familiar with the opinions then to be held by the members of that court on the question of the intention of the parties. For not only will the courts of two states differ as to the method of applying the rule; even the courts of the same state at different times will apply the law differently. Take, for instance, the question of the intention of the parties as to the law governing a shipment of goods by sea. The English courts and the federal courts in the United States were called upon simultaneously to decide the question of the intention of the parties as to the law which should govern a shipment of goods from the United States to England. In both cases the court laid most stress upon the language of the bill of lading, and this language was identical in both cases. Both cases went through several courts. As a final result the Supreme Court of the United States held that the parties intended to be governed by the law as laid down in the United States courts,[1] while the English Court of Appeal held that the parties intended to submit their contract to the law of England.[2] Counsel advising on the transaction here brought in question would be obliged, in order to inform clients as to the law which applied to the contract, to know whether the suit was eventually to be brought in a federal court in the United States or in the English courts. If he could venture to predict that the suit would be brought in England, he might with some confidence assert that for one reason or another, or for none at all, the court would find that the parties intended to be governed by the law of England. But suppose he could foresee that it was to be brought in the federal court of the United States. It would be impossible for him to guess what circumstance that court would rely upon in determining the intention of the parties. Would they presume that the law of the place of making was intended to govern, as was held in the case just cited? or the law of the place of performance, as was held in a later case?[3] Would considerable effect be given to a consideration of what law would make the obligation valid? or finally, would the court say (as it usually does in insurance cases) that the parties could not avoid the requirements of the law

[1] Liverpool & G. W. S. Co. *v.* Phenix Ins. Co., 129 U. S. 377.

[2] *In re* Missouri S. S. Co., 42 Ch. D. 321.

[3] Hall *v.* Cordell, 142 U. S. 116.

of the place of making by an intention to adopt the law of another state? [1]

On a question of this sort counsel are dealing with a matter on which knowledge of the common law can throw no light and the precedents are practically valueless. As has been seen, the courts are inclined now to lay stress on one circumstance and now on another in finding the intention of the parties. The parties must, therefore, take the risk of what the court may find their intention to have been.

It may be said that counsel sufficiently familiar with the law might advise the parties to agree expressly upon the law of one state or the other as the law intended by them to apply to their agreement. Here, however, we are met by the difficulty that the courts will not necessarily enforce such an agreement or accept it as an expression of the real *bonâ fide* intention of the parties. In the first place, as was pointed out in considering Professor Dicey's view of the subject, the courts say in general that this is the mere expression of a wish that a certain law should be applied to their obligation, and not a complete submission of the contract to the state in question as the seat of its existence. In the second place, the courts may (and very probably would) refuse to apply the law agreed upon, on the ground that it was not the real *bonâ fide* desire of the parties to adopt that rule, but the agreement was merely the expression of a wish to escape from the burdens of the law of the place of making the contract. It is impossible to tell in advance whether the court in which the suit is brought will say, as several courts say, that no such agreement will be given any effect whatever; or whether it will say that there is in the case, notwithstanding the agreement, no *bonâ fide* adoption of that law; or whether, in the third place, the court will say that to allow the parties to agree upon this law would be allowing them to avoid the obligations of some other law, and for that reason their agreement will be given no effect.

In short, in cases of this sort, it is practically impossible to predict what any court in which this form of rule is laid down will say as to the intention of the parties, and it is therefore impossible for counsel to advise clients, in advance of action, how they can make a valid and binding agreement.

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[1] New York L. Ins. Co. *v.* Cravens, 177 U. S. 389.

2.

The second rule to be discussed is that which governs the nature and validity of a contract by the law of the place of performance. In theory the objection to this doctrine is, in brief, that it enables the parties to substitute for the law under which they act in making the contract another law, namely, the law of the place of performance. If the law of the place where the parties act refuses legal validity to their acts, it is impossible to see on what principle some other law may nevertheless give their acts validity. The law of the place of performance can have no effect as law in another place, namely, the place where the parties act; for it is a fundamental doctrine of our law that "the laws of every state affect and bind directly . . . all contracts made, and acts done within it. A state may therefore regulate . . . the validity of contracts and other acts done within it; the resulting rights and duties growing out of these contracts and acts." [1] Any attempt to make the law of the place of performance govern the act of contracting is an attempt to give to that law exterritorial effect. It enables the parties to confer upon their acts a legal effect which the law under which the acts are done refuses to confer upon them.

An attempt is sometimes made to limit the generality of this rule by providing that the law of the place of performance will govern only where that place was *bonâ fide* chosen by the parties as the place where they desired performance, not merely as a place to which they turned in order to obtain the benefit of its laws. This modification of the rule, however, does not present us with a theoretically more defensible rule, while it involves uncertainty of operation and is therefore less practical. There are really four classes of problems which may arise in cases of this sort. (1) An agreement is valid where made, but the performance is forbidden where it is to be performed. In such a case if the performance is forbidden by law the contract certainly should not oblige the contractor to carry out his agreement where, even after the contract was made, performance was forbidden by the law of the place of performance, though in an English case, it was held that a suit would lie for non-performance.[2] The prevailing doctrine in such a case is that such an agreement, if its performance was forbidden at the time it was made, would never become

[1] Story, Conf. Laws, § 18.

[2] Jacobs *v.* Crédit Lyonnais, 12 Q. B. D. 589.

a binding obligation; the contract would be invalid even by the law of the place of making. (2) An agreement made in one state, where it is valid, to be performed in another state where the act of performance is not forbidden, but where the agreement if made there would not be legally binding. In such a case there is no theoretical reason why the contract should not be valid. In almost every jurisdiction in the world the agreement would be valid if the question were one merely of the form of entering into the agreement, and there seems to be no reasonable ground for distinguishing between the form required for validity and any other circumstance bearing on the validity. To hold in such a case that the law of the place of performance governs the validity of the contract is to enable one state to dictate to another what acts done in that other's borders shall and what shall not result in a legal obligation. In other words, it enables one state to extend its laws over to territories of another. (3) An agreement made in one state, where the act of agreeing is forbidden or has no legal validity, to do an act in another state where the agreement would be legally binding. Here, again, if the law of the state of performance is applied to the validity of the obligation, it enables an act to be done and to have legal validity in spite of the fact that the sovereign where it is done forbids it and refuses to give legality to it. (4) An agreement made in one state to do an act (forbidden in the state of agreement) in a second state where the doing of the act is not forbidden. In this case it would seem that since the performance of the contract only and not the making of it is forbidden in the state where it is made, there is nothing in the law of that state to make the contract itself invalid.

In all these cases the matter must, it seems, be determined theoretically by the law governing the transaction, *i.e.*, the law of the place where the parties act in making their agreement. If by that law their acts have no legal efficacy, then no other state can give them greater effect. If by the law of that state their acts created a binding obligation upon the parties, then the parties who have acted under that law must be bound by it.

When we come to consider the practical effect of the rule under consideration we find that it has one very great advantage over the rule previously considered. It is more certain in operation, and its application does not generally depend upon the interpretation to be placed by the court upon the meaning of the parties' acts. But while

this is true, there are nevertheless in many cases other circumstances interfering with the smooth operation of the rule. A contract must be made at a single moment once for all, and there can be but one act of contracting. The moment the parties are bound by a contract, that moment the obligation is forever fixed. The fact is, however, very different as to the performance. The performance of a single contract may call for a long-continued series of acts, performable in various places. The performance may begin in one state and finish in another, or there may be acts to be done in two different states in order to complete a performance. Where this is the case, as it often is, the rule that the validity of a contract is governed by the law of the place of performance is difficult of application. To meet this difficulty there are two alternatives. The first is in such a case to depart from the law of the place of performance altogether, and to apply to such a contract the law of the place of making only. This was the alternative adopted in the case of Morgan *v.* New Orleans, Mobile, and Texas Railroad,[1] where, in the case of a contract performable partly in New York and partly in Louisiana, Alabama, Mississippi, and Texas, Mr. Justice Bradley said, "In this embarrassment I do not know that I can do better than to fall back on the general rule that the contract is to be governed by the law where it is made." This forced application of a different rule in order to avoid embarrassment involves the abandonment of the principle of the rule that the contract is governed by the law of the place of performance. In other words, a mistaken theory found impracticable in operation yields to expediency.

The second alternative is to apply to the validity of the contract, when the question arises as to any one breach of it, the law of the place where that breach happened. In other words, the contract would be held valid as to some acts of performance, invalid as to others, according to the place where those acts were to be done. This alternative has been adopted in New Hampshire, for instance, in the case of contracts of carriage, with almost grotesque results. A shipment of goods perfectly valid where made would, according to this doctrine, put upon the carrier the strict liability of the common carrier while he was carrying the goods through certain states, while in other states it would enable him to claim that he was under no liability whatever.

A second practical objection to this rule arises from the difficulty

[1] 2 Woods 244.

of getting expert legal advice at the time when the formation of the agreement is under consideration. If two parties are contemplating the formation of a contract and are seeking advice upon it, they must almost necessarily go to a lawyer in the place where the negotiations are being carried on. He can, in the nature of things, give expert advice only in the law of his own state. If the contract is to be governed not by that law, but by the law of the place of performance, it will be necessary for him to advise on a law in which he is not expert, and where he is required to make special study and is particularly liable to mistake. All that was said in the discussion of the rule first under consideration as to the practical need of obtaining advice before acting applies here. The difficulty is less, to be sure, because if this rule universally prevailed the lawyer consulted would have no doubt as to what law should be applied. But he would still be unable to give expert advice in that law; and the parties would therefore either be obliged to get along with the best advice they were able to obtain on the spot, or else they would be obliged to send into the state of performance for an opinion, with all the difficulty, expense, and delay which that necessity would entail.

3.

We come now to the third suggested rule, that the law of the place of making the agreement governs the nature and validity of the contract. That this rule is theoretically sound there can be no doubt. Even those judges and writers who finally lay down the different rule state this, first, as the natural one. The rule is based on the necessity of some law to raise an obligation between parties, and of this there can be no question. If two parties agree to do a thing, their agreement does not and cannot create any binding obligation to do it. The obligation created by the promise is merely a moral and social one, with which the law has nothing to do. It is only when the law affixes to the promise a legal obligation of performance that the parties can be said to have entered into a contract in a true sense. As the author has said, in another place, "in the legal sense, all rights must be created by some law." [1]

"The question whether a contract is valid, that is, whether to the agreement of the parties the law has annexed an obligation to per-

[1] Summary of the Conflict of Laws, § 2.

form its terms, can on general principles be determined by no other law than that which applies to the acts, that is, by the law of the place of contracting. If the law at that place annexes an obligation to the acts of the parties, the promisee has a legal right which no other law has power to take away except as a result of new acts which change it. If on the other hand the law of the place where the agreement is made annexes no legal obligation to it, there is no other law which has power to do so." [1]

So far is this the case that it is everywhere agreed that where a statute of the state where the parties contract applies to the contract, no other law, whether that of the place of performance or any other, can avoid the effect of the statute.[2] This doctrine gives full scope to the territoriality of law, and enables each sovereign to regulate acts of agreement done in his own territory.

Practically this is the best rule. It is open to none of the objections urged against the others. In the first place, there is no uncertainty in the application of the rule. There can only be one place in which a contract is made, and what that place is can never be subject to great or serious doubt. There is practically no difference of opinion as to where a contract is made among the authorities on any particular case. The act of contracting is a momentary act, and the contract must arise at some particular moment as a result of an act done in some one state.

The law of the place of making is furthermore the law which it is easiest for the parties to follow. An objection has been made to it on the ground that the place of making is merely accidental, that parties from different states may happen to meet in a third state and there form an agreement, and that when that happens there can be no presumption that these parties know the law of that state. The answer must be that the so-called presumption that the parties know the law is on the face of it false in fact, and is a mere way of saying that parties are bound by the law under which they act, whether they know it or not. Parties do not in fact, in most cases, know what the law is under which they act, yet they are justly held to be bound whether they know it or not, because if they do not choose to take the risk of what it may be, they may consult counsel learned in

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[1] Summary of the Conflict of Laws, § 90.

[2] Fowler *v.* Equitable Trust Co., 141 U. S. 384; New York L. Ins. Co. *v.* Craven, 177 U. S. 389.

the law and find out what it is. In other words, parties embarking on an important enterprise should consult counsel and be advised as to the legal nature of what they are about to do. Now if the parties happen to meet in a certain state and there enter into a treaty for a contract, and their business is so important that they wish to be sure that they are proceeding in accordance with the law, they will be almost certain to consult counsel. Neither party is likely to go back to his own state and there take advice. While, therefore, a party cannot be presumed to know the law of that place, he can very properly be called upon to consult counsel there. In the practical sense, the law which it is easiest for parties to act under is the law of the place where they act; and it follows that the rule which is habitually applied to the validity of their acts is the rule which is based on the most practical considerations.

It thus appears that the principle which is both sound theoretically and most practical in operation is the principle that contracts are in every case governed as to their nature and validity by the law of the place where they are made.

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